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Proposed statement of position : Accounting by insurance and other enterprises for guaranty-fund and certain other insurance-related assessments ;Accounting by insurance and other enterprises for guaranty-fund and certain other insurance-related assessments; Exposure draft (American Institute of Certified Public Accountants), 1996, Dec. 5

American Institute of Certified Public Accountants. Accounting Standards Executive Committee

EXPOSURE DRAFT

PROPOSED STATEMENT OF POSITION

ACCOUNTING BY INSURANCE AND OTHER ENTERPRISES FOR GUARANTY-FUND AND CERTAIN OTHER INSURANCE-RELATED ASSESSMENTS

DECEMBER 5, 1996

Prepared by the Accounting Standards Executive Committee
American Institute of Certified Public Accountants

Comments should be received by March 5, 1997, and addressed to
Elaine M. Lehnert, Technical Manager,
Accounting Standards, File 3162.AS
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775
or via the Internet to ELEHNERT@AICPA.ORG

800106

Any individual or organization may obtain one copy of this document without charge until the end of the comment period by writing to the AICPA Order Department, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

December 5, 1996

Accompanying this letter is an exposure draft of a proposed Statement of Position (SOP), *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments.* A summary of the significant provisions of the proposed SOP is included in the forepart of that document.

The purpose of the exposure draft is to solicit comments from preparers, auditors, and users of financial statements and other interested parties. AcSEC invites comments on all matters in the proposed SOP and particularly on the following specific issues. Respondents need not comment on all of the issues and are encouraged to comment on additional issues. Respondents should refer to specific paragraph numbers and include reasons for any suggestions or comments.

Scope

Issue 1: The proposed SOP would apply to all insurance enterprises (stock and mutual), including life and health insurance enterprises, property and casualty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, insurance pools (other than public-entity risk pools), syndicates, captive insurance companies, and other enterprises subject to guaranty-fund and certain other insurance-related assessments. In addition, entities that are not insurance enterprises but that self insure against loss or liability and are subject to guaranty-fund and certain other insurance-related assessments are included in the scope of this proposed SOP. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?

Refer to paragraph 8.

Issue 2: This proposed SOP would apply to state- and regulatory-imposed assessments related directly or indirectly to underwriting activities and also to insurance-related assessments imposed by other authorities. Are there transactions that are captured by this scope that should be excluded? Alternatively, are there other assessments or transactions not captured by the scope that should be included?

Refer to paragraph 9.

Prospective-Premium-Based Assessments

Issue 3: Paragraph 19b of the proposed SOP specifies that for prospective-premium-based assessments the event that obligates the member insurer is the writing or renewal of the premiums on which the assessments are expected to be based. Alternatively, the insolvency could be considered the underlying cause of an insurance enterprise's obligation to pay future assessments. Is the writing of the premium the appropriate event to trigger the liability for prospective-based-premium-based assessments, or would the insolvency be more appropriate? Why or why not?

Refer to paragraphs 30-37 for the basis for AcSEC's conclusions.

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Present Value

Issue 4: The proposed SOP allows a liability for assessments to be recorded at its present value by discounting the estimated future cash flows at an appropriate interest rate when the amount and timing of the cash payments are fixed or readily determinable. Should discounting be permitted? Should it be required? Why or why not?

Refer to paragraph 40 for the basis for AcSEC's conclusions.

Transition

Issue 5: This proposed SOP would require adoption at the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Would another method of transition be more appropriate?

Refer to paragraph 23.

Effective Date

Issue 6: This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1997, with earlier adoption permitted. Is the effective date appropriate?

Refer to paragraph 23.

Responses should be addressed to Elaine Lehnert, Technical Manager, Accounting Standards, File 3162.AS, American Institute of Certified Public Accountants, 1211 Avenue of the Americas, New York, NY 10036-8775, in time to be received by March 5, 1997. Responses also may be sent by electronic mail over the Internet to ELEHNERT@AICPA.ORG.

Written comments on this exposure draft will become part of the public record of the AICPA and will be available for public inspection at the AICPA library for one year after March 5, 1997.

Sincerely,

G. Michael Crooch, CPA
Chair
Accounting Standards
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Robert W. Granow, CPA
Chair
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Jane B. Adams, CPA
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SUMMARY

This proposed Statement of Position (SOP) would provide guidance on accounting by insurance and other enterprises for guaranty-fund and certain other insurance-related assessments. The SOP provides:

- Guidance for determining when an insurance enterprise should recognize a liability for guaranty-fund and other assessments.
- Guidance on how to measure the liability and allows for the discounting of the liability, if the amount and timing of the cash payments are fixed and reliably determinable.
- Criteria for when an asset may be recognized for a portion or all of the assessment liability or paid assessment that can be recovered through premium tax offsets or policy surcharges.
- Requirements for disclosure of certain information.

This SOP would be effective for financial statements for fiscal years beginning after December 15, 1997. Early adoption is encouraged. Previously issued annual financial statements should not be restated. Initial application of this SOP should be as of the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Insurance enterprises should report the effect of initially adopting this SOP in a manner similar to a cumulative effect of a change in accounting principle (refer to paragraph 20 of Accounting Principles Board [APB] Opinion No. 20, *Accounting Changes).*

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FOREWORD

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSEC's fifteen members, and (3) a proposed final document that has been approved by at least ten of AcSEC's fifteen members. The document is cleared if at least five of the seven FASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in their review of proposed projects and proposed documents include the following.

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.

2. The proposal will result in an improvement in practice.

3. The AICPA demonstrates the need for the proposal.

4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, prior to clearance, the FASB will propose suggestions, many of which are included in the documents.

STATEMENT OF POSITION

ACCOUNTING BY INSURANCE AND OTHER ENTERPRISES FOR GUARANTY-FUND AND CERTAIN OTHER INSURANCE-RELATED ASSESSMENTS

INTRODUCTION

1. Insurance enterprises are subject to a variety of assessments, including those by state guaranty funds and workers' compensation second-injury funds. Some entities other than insurance enterprises may be subject to insurance-related assessments because they self insure against loss or liability. This SOP refers to all entities that are subject to guaranty-fund and other insurance-related assessments as insurance enterprises or member insurers. Current accounting practice by insurance enterprises for assessments and related recoveries is diverse. Some of the diversity is a result of fundamental differences in the methods for assessing insurers. However, similar assessments are not being accounted for comparably among insurance enterprises. Some insurance enterprises account for assessments on a pay-as-you-go (cash) basis, whereas others account for assessments on an accrual basis. Furthermore, the methods for accrual are varied. Some insurance enterprises recognize a liability for the entire portion of the estimated cost of an insolvency at the time of the insolvency. Yet others recognize a liability related to assessments that are dependent on the writing of future premiums as those premiums are written. This Statement of Position (SOP) provides guidance on accounting by insurance enterprises for guaranty-fund and certain other insurance-related assessments.

2. As the prevalence and magnitude of guaranty-fund and other assessments have increased, concern about the diversity in practice also has increased. This SOP was undertaken to reduce diversity in practice, improve comparability of amounts reported, and improve disclosures made by insurance enterprises with respect to guaranty-fund and other assessments.

BACKGROUND INFORMATION

Guaranty-Fund Assessments

3. Most states have enacted legislation establishing guaranty funds. The state guaranty funds assess insurance enterprises licensed to sell insurance in the state (member insurers) to provide for payment of covered claims or to meet other insurance obligations, subject to prescribed limits, of insolvent insurance enterprises. Most state guaranty funds assess member insurers for costs related to a particular insolvency after the insolvency occurs. At least one state, however, assesses member insurers prior to insolvencies.

4. State guaranty funds use a variety of methods for assessing member insurers. This SOP identifies three primary types of guaranty-fund assessments.

a. Retrospective-premium-based assessments. Most state guaranty funds covering benefit payments of insolvent life and health insurance enterprises assess member insurers based on premiums written *prior* to the insolvency. Assessments for a given insolvency are based on an allocation derived from pre-insolvency premiums and usually are made over several years after the insolvency occurs. Annual assessments generally are limited to an established percentage of a member insurer's average premiums for the three years preceding the insolvency.

b. _Prospective-premium-based assessments_. Most state guaranty funds covering claims of insolvent property and casualty insurance enterprises assess member insurers based on premiums written *after* the insolvency. Assessments for a given insolvency usually are made over several years after the insolvency occurs. Annual assessments generally are limited to an established percentage of a member insurer's premiums for the year preceding the assessment.

c. _Prefunded-premium-based assessments_. At least one state uses this type of assessment to cover claims of insolvent property and casualty insurance enterprises. This type of assessment is intended to prefund the costs of future insolvencies. Assessments are made prior to any particular insolvency and are based on the current level of written premiums of the member insurer. Rates to be applied to future premiums are adjusted as necessary.

5. State laws often allow for recoveries of guaranty-fund assessments by member insurers through such mechanisms as premium tax offsets, policy surcharges, and future premium rate structures.

Other Assessments

6. Insurance enterprises are subject to a variety of other assessments. Many states have established other funds supported by assessments on member insurers. The most prevalent uses for such assessments are (a) to fund operating expenses of state insurance regulatory bodies (for example, the state insurance department, state guaranty fund, or workers' compensation board), referred to as administrative-type in this SOP, and (b) to fund second-injury funds.[1]

7. The primary methods used to assess member insurers for these other assessments are–

a. _Premium-based assessments_. Generally the fund will apportion the assessment based on the member insurer's written premiums.[2] The base year of premiums may be the current year or the year preceding the assessment.

b. _Loss-based assessments_. Generally the fund will apportion the assessment based on the member insurer's incurred losses or paid losses in relation to that amount for all member insurers in the particular jurisdiction.

SCOPE

8. This SOP applies to all insurance enterprises (stock and mutual), including life and health insurance enterprises, property and casualty insurance enterprises, title insurance enterprises, mortgage guaranty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, insurance pools (other than public-entity risk pools), syndicates, and captive insurance companies. In addition, this SOP applies to entities other than insurance enterprises that are subject to insurance-related assessments because they self insure

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[1] Second-injury funds provide reimbursement to insurance carriers or employers for workers' compensation claims related to a second injury. Second-injury funds protect employers from having to pay a larger cost for an employee's injury when that injury combined with a prior accident or disability is greater than what the second accident alone would have produced. The intent of the fund is to help insure that employers are not made to suffer a greater monetary loss or increased insurance costs because of hiring previously injured employees.

[2] These assessments may also be applied at the county, municipality, or other such level.

against loss or liability.[3] Such entities are referred to in this SOP as insurance enterprises or member insurers.

9. Assessments covered by this SOP include any charge mandated by statute or other regulatory authority that is related directly or indirectly to underwriting activities, except for income taxes and premium taxes. This SOP does not apply to amounts payable or paid related to reinsurance contracts or arrangements that are in substance reinsurance, including assumed reinsurance activities and certain involuntary pools that are covered by Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts.*

CONCLUSIONS

Reporting Liabilities

10. Insurance enterprises should recognize liabilities for guaranty-fund, second-injury fund, and loss-based administrative-type assessments when all of the following conditions are met:

a. An assessment has been asserted or information available prior to issuance of the financial statements indicates it is probable that an assessment will be asserted.

b. The underlying cause of the asserted or probable assessment has occurred on or before the date of the financial statements.

c. The amount of loss can be reasonably estimated.

11. Insurance enterprises should recognize liabilities for administrative-type assessments that are not loss based when all of the following conditions are met:

a. An assessment has been asserted or information available prior to issuance of the financial statements indicates it is probable that an assessment will be asserted.

b. The underlying cause of the asserted or probable assessment has occurred on or before the date of the financial statements.

12. *Probability of Assessment*. For premium-based guaranty-fund assessments, except for prefunded guaranty-fund assessments, it is presumed to be probable that a member insurer will be assessed when a formal determination of insolvency occurs.[4] For prefunded guaranty-fund assessments and premium-based administrative-type assessments (as defined in paragraph 6), it is presumed to be probable that a member insurer will be assessed when the premiums on which the assessments are expected to be based are written. For administrative-type and second-injury funds that are funded by loss-based assessments, it is assumed to be probable that a member

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[3] For example, one state specifies that self-insurers of workers' compensation should use as a base for assessment the amount of premium the self-insurer would have paid if it had insured its liability with an insurer for the previous calendar year.

[4] For purposes of this SOP, a formal determination of insolvency occurs when a member insurer meets a state's (ordinarily the state of domicile of the insolvent insurer) statutory definition of an insolvent insurer. In most states, the member insurer must be declared to be financially insolvent by a court of competent jurisdiction. In some states, there must also be a final order of liquidation.

insurer will be assessed when the losses on which the assessments are expected to be based are incurred.

13. _Underlying Cause_. Because of the fundamental differences in how assessment mechanisms operate, the event that makes it probable that an assessment will be made (for example, an insolvency) may not be the event that obligates a member insurer. The following defines the event that is the underlying cause that obligates a member insurer to pay an assessment for each type of assessment defined in this SOP.

14. For premium-based assessments, the event that obligates the member insurer is a member insurer's writing the premiums or becoming obligated to write or renew (such as multiple-year, noncancelable policies) the premiums on which the assessments are expected to be based. Some states, through law or regulatory practice, provide that an insurance enterprise cannot avoid paying a particular assessment even if that insurance enterprise reduces its premium writing in the future. In such circumstances, the event that obligates the member insurer is a formal determination of insolvency.

15. For loss-based assessments, the event that obligates a member insurer is a member insurer's incurring the losses on which the assessments are expected to be based.

16. _Ability to Reasonably Estimate the Liability_. One of the conditions in FASB Statement No. 5, *Accounting for Contingencies,* for recognition of a liability is that the amount can be reasonably estimated. FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, provides that some amount of loss can be reasonably estimated when information available indicates that the estimated amount of loss is within a range of amounts. When no amount within the range is a better estimate than any other amount, the minimum amount in the range shall be accrued.

17. Insurance enterprises can obtain information to assist in estimating the total guaranty-fund cost or the following years' assessments (as appropriate) for an insolvency from organizations such as the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and the National Conference of Insurance Guaranty Funds (NCIGF). An insurance enterprise need not be able to compute the exact amounts of the assessments or be formally notified of such assessments by a guaranty fund to make a reasonable estimate of its share of such costs. Instead, insurance enterprises may have to make assumptions about future events, such as when the fund will incur costs and pay claims, that will determine the amounts and the timing of assessments. Information about current or projected market shares, premiums by state, and premiums by line of business generally should be used to estimate the amount of an insurance enterprise's future assessments that meet this criterion for accrual.

18. Estimates of loss-based assessments should be consistent with estimates of the underlying incurred losses and should be developed based on enacted laws and expected assessment rates.

Application of Guidance

19. A discussion on applying the conclusions in paragraphs 10 through 18 to the three methods of assessing guaranty-fund assessments and the two methods of assessing other assessments (as described in paragraphs 4 and 7) follows:

a. _Retrospective-premium-based assessments_. An assessment is probable of occurring when a formal determination of insolvency occurs. At that time, the premium that obligates the member insurer for the assessment liability has already been written. Accordingly, an insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability for the entire amount of future assessments related to a particular insolvency when a formal determination of insolvency is rendered.

b. *Prospective-premium-based assessments*. The event that obligates the member insurer for the assessment liability generally will be when the insurance enterprise writes, or is obligated to write,[5] the premiums on which the expected future assessments are to be based. Therefore, the event that obligates the member insurer generally will not have occurred at the time of the insolvency.

   In states that, through law or regulatory practice, provide that an insurance enterprise realistically cannot avoid paying a particular assessment in the future (even if the insurance enterprise reduces premium writings in the future), the event that obligates the member insurer is a formal determination of insolvency. An insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability for the entire amount of future assessments that cannot be avoided related to a particular insolvency when a formal determination of insolvency occurs.

   In states without such a law or regulatory practice, the event that obligates the member insurer occurs when the insurance enterprise writes, or is obligated to write, the premiums on which the expected future assessments are to be based. An insurance enterprise that has the ability to reasonably estimate the amount of the assessments should recognize a liability when the related premiums are written or when the insurance enterprise becomes obligated to write the premiums.

c. *Prefunded-premium-based assessments*. A liability for an assessment arises when premiums are written. Accordingly, an insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability as the related premiums are written.

d. *Premium-based assessments for other assessments*. Premium-based assessments for "other assessments," as defined in paragraph 6, would be accounted for in the same manner as prefunded-premium-based assessments described above.

e. *Loss-based assessments*. An assessment is probable of being asserted when the loss occurs. The underlying cause of the assessment also has occurred when the loss occurs. Accordingly, an insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability as the related loss occurs.

Present Value

20. Current practice is to allow, but not require (with limited exceptions, such as pensions and postretirement benefits), discounting of liabilities to reflect the time value of money when the aggregate amount of the obligation and the amount and timing of the cash payments are fixed or reliably determinable for a particular liability. Similarly, for assessments that meet those criteria, the liability may be recorded at its present value by discounting the estimated future cash flows at an appropriate interest rate.

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[5] For example, multiple-year contracts under which an insurance enterprise has no discretion to avoid writing future premiums.

Reporting Assets for Premium Tax Offsets and Policy Surcharges

21. When it is probable that a paid or accrued assessment will result in an amount that is expected to be recoverable from premium tax offsets or policy surcharges, an asset should be recorded for that recovery in an amount that is determined based on current laws and projections of future premium collections or policy surcharges from in-force policies.[6] Accordingly, asset recognition would be limited normally to life and health enterprises that are subject to retrospective-premium-based assessments. Amounts that are expected to be recoverable through their inclusion in future premium rate structures should not be recognized as assets. Any assets recognized that are related to liabilities reported at discounted amounts should be discounted similarly.

Disclosures

22. FASB Statement No. 5, FASB Interpretation No. 14, and American Institute of Certified Public Accountants (AICPA) SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, address disclosures related to loss contingencies. That guidance is applicable to assessments covered by this SOP. Additionally, if amounts have been discounted, the insurance enterprise should disclose in the financial statements the undiscounted amounts of the liability and any related asset for premium tax offsets or policy surcharges as well as the discount rate used. If amounts have not been discounted, the insurance enterprise should disclose in the financial statements the amounts of the liability, any related asset for premium tax offsets or policy surcharges, the periods over which the assessments are expected to be paid, and any recorded premium tax offsets or policy surcharges expected to be received.

EFFECTIVE DATE AND TRANSITION

23. This SOP is effective for financial statements for fiscal years beginning after December 15, 1997. Early adoption is encouraged. Previously issued annual financial statements should not be restated. Initial application of this SOP should be as of the beginning of an insurance enterprise's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Insurance enterprises should report the effect of initially adopting this SOP in a manner similar to a cumulative effect of a change in accounting principle (refer to paragraph 20 of Accounting Principles Board [APB] Opinion No. 20, *Accounting Changes).*

The provisions of this Statement of Position need not be applied to immaterial items.

[6] Property and casualty enterprises would be limited to recognition of assets related to premiums that have already been written. For purposes of this SOP, in-force premiums exclude expected renewal premiums from short-duration property and casualty policies.

BASIS FOR CONCLUSIONS

24. This section discusses considerations that were deemed significant by members of the AICPA Accounting Standards Executive Committee (AcSEC) in reaching the conclusions in this SOP. It provides background information and includes reasons for accepting certain views and rejecting others.

25. The financial reporting literature does not address explicitly accounting for guaranty-fund and other assessments and related premium tax offsets and policy surcharges of insurance enterprises. AcSEC considered the following pertinent literature in reaching the conclusions in this SOP:

- FASB Statement No. 5, *Accounting for Contingencies*
- FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*
- FASB Statement No. 87, *Employers' Accounting for Pensions*
- FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*
- FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*
- AICPA SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*
- Emerging Issues Task Force (EITF) Issue No. 91-10, *Accounting for Special Assessments and Tax Increment Financing Entities*
- EITF Issue No. 92-13, *Accounting for Estimated Payments in Connection with the Coal Industry Retiree Health Benefit Act of 1992*
- EITF Issue No. 93-5, *Accounting for Environmental Liabilities*
- EITF Issue No. 93-6, *Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*
- FASB Concepts Statement No. 6, *Elements of Financial Statements*
- Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 62, *Discounting by Property/Casualty Insurance Companies*
- SEC SAB No. 92, *Accounting and Disclosures Relating to Loss Contingencies*

Reporting Liabilities

26. FASB Statement No. 5, paragraph 8, requires accrual of a liability when "a. Information available prior to issuance of the financial statements indicates that it is probable that . . . a liability has been incurred at the date of the financial statements" and "b. The amount of loss can be reasonably estimated." With respect to assessments, FASB Statement No. 5, paragraph 33, states, in part:

> The following factors, among others, must be considered in determining whether accrual and/or disclosure is required with respect to pending or threatened litigation and actual or possible claims and assessments:
>
> a. The period in which the underlying cause (i.e., the cause for action) of the pending or threatened litigation or of the actual or possible claim or assessment occurred.

FASB Statement No. 5, paragraph 34, states, in part:

> As a condition for accrual of a loss contingency, paragraph 8(a) requires that information available prior to the issuance of financial statements indicate that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Accordingly, accrual would clearly be inappropriate for . . . assessments whose underlying cause is an event or condition occurring after the date of financial statements . . . .

27. Therefore, for a liability to be recognized in the financial statements, the underlying cause must have occurred on or before the date of the financial statements. The SOP identifies the event that obligates a member insurer for each type of assessment, which is the underlying cause.

28. In reaching the conclusions in this SOP concerning when to recognize liabilities for assessments, AcSEC considered the definition of liabilities in paragraph 35 of FASB Concepts Statement No. 6 and the concept of present obligation:

> Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. [Footnote references omitted.]

29. To apply the definition of liabilities in paragraph 35 of FASB Concepts Statement No. 6 to assessments, AcSEC considered the underlying cause that creates a present obligation for insurance enterprises to pay assessments. In order to have a present obligation, the insurance enterprise realistically must have little or no discretion to avoid the future sacrifice, and the event that obligates the insurance enterprise must have occurred no later than the date of the financial statements.

AcSEC concluded that the fundamental differences in the assessment mechanisms justified identifying different events for the three primary types of guaranty-fund assessments and the two types of other assessments (as stated in paragraphs 4 and 6) that would obligate the insurance enterprise and require recognition of a liability.

30. *Assessments Based on Premiums*. Guaranty funds and other assessment funds allocate their costs to insurance enterprises through assessments based on premiums or losses (See paragraph 7). For assessments based on premiums, AcSEC concluded that the writing of premiums on which a potential assessment is based is the underlying cause of an insurance enterprise's obligation to pay cash in the future. In some circumstances, the insurance enterprise has the option of reducing or eliminating its premium-writing activity, thereby reducing or eliminating its assessment. As discussed in paragraph 18, however, some states, through law or regulatory practice, provide that an insurance enterprise cannot avoid paying a particular assessment even if the insurance enterprise reduces premium writings in the future. For example, in certain states, an insurance enterprise may remain liable for assessments even though the insurance enterprise discontinues the writing of premiums.

31. In making its decision, AcSEC was influenced by the fact that insurance enterprises that enter a new state or increase market share in a state will be required to pay assessments for an insolvency that occurred before they entered that state or increased their market share. The fact that such insurance enterprises will have to pay assessments for insolvencies that occurred previously supports the conclusion that the writing of premiums is the underlying cause of the assessments. The alternative conclusion, that is, to recognize the liability based on expected future premiums, would require a new market entrant to recognize a liability on the date it commences business.

32. Alternative view. For premium-based guaranty-fund assessments, AcSEC considered whether the insolvency should be considered the underlying cause of an insurance enterprise's obligation to pay future assessments, irrespective of the legal basis used by the state insurance department to determine the amount due from each insurance enterprise subject to the assessment. Under this view supported by a minority of AcSEC, an enterprise would recognize a liability when an assessment is probable upon the formal determination of insolvency and when the amount of the

assessment can be reasonably estimated. Those that supported the insolvency as the recognition criterion did so under the theory that the insurance industry will eventually be responsible for the entire liability and most companies will not cease writing premiums and avoid the assessment.

33. FASB Statement No. 5 may be read to support either recording a liability at the date of the insolvency or recording a liability when the premium is written. In order to determine when to record the liability for the assessment, defining the event that gives rise to the liability was necessary. AcSEC concluded that the insolvency is the initial event that will obligate the insurance enterprise to a liability at some point either currently or in the future. AcSEC further concluded that if at the time of the insolvency law or regulatory practice obligates the insurance enterprise to pay some portion of the insolvency, a liability should be recorded. However, if an insolvency occurs but no law or practice obligates the insurance enterprise, then the event that binds the insurance enterprise is the writing of the premium. Although the insolvency is what obligates the guaranty fund, AcSEC concluded that writing the premium is the event that requires recognition of a liability for prospective-premium-based assessments when an insurance enterprise is not legally obligated to pay assessments until future premiums are written.

34. AcSEC believes that a number of analogies support the conclusions in this SOP. For example, in EITF Issue No. 93-6, a ceding enterprise would recognize a liability for obligatory retrospectively rated contracts only to the extent that it has an obligation to pay cash (or other consideration) to a reinsurer that would not have been required in the absence of experience under the contract. Furthermore, EITF Issue No. 93-6 specifically prohibits ceding companies from recognizing liabilities for amounts expected to be paid in the future that relate to prior catastrophe losses (for example, through increased costs of reinsurance) when no contractual obligation to make such payments exists. AcSEC believes that insurance enterprises have no contractual obligation to pay assessments until the premiums on which the assessments are to be based are written.

35. In EITF Issue No. 92-13, the EITF reached a consensus that allowed enterprises with operations in the coal industry to account for their obligations under the Coal Industry Retiree Health Benefit Act of 1992 (which created a fund to pay benefits related to certain coal-industry benefit trusts that were operating at deficits) as multiemployer pension plans. Guaranty funds are similar to multiemployer pension plans in that each insurance enterprise's payments to the fund are used to satisfy the general obligations of the fund and are not segregated for the benefit of any one enterprise.

36. AcSEC also believes that accounting for claims-made insurance provides an appropriate analogy. In claims-made insurance, the insured event is the reporting, during the term of the policy or within a specified period following the coverage period, to the insurer of a claim for a covered loss. For such policies, insurance enterprises estimate a liability for unpaid claims based only on claims reported, despite the fact that there may be other losses that have been incurred that eventually will result in claims to that insurance enterprise. The agreement between the insurer and the insured is that the insurance enterprise is not obligated to cover those unreported losses, unless that insurance enterprise is providing coverage under a claims-made policy when the claim is made. Similarly, the substance of the arrangement for most premium-based assessment mechanisms is that an insurance enterprise is obligated to pay assessments only when the premiums on which the assessments are to be based are written.

37. Although insurance enterprises may be able to determine that future assessments are probable for some period of time before a formal determination of insolvency occurs, AcSEC concluded that assessments should not be considered probable until a formal determination of insolvency occurs, unless the assessments are being made by a prefunded guaranty fund. AcSEC believes that the formal determination date is the most objectively determinable measurement date

and that requiring its use will foster comparability in reporting. Furthermore, AcSEC believes mere speculation about an insurance enterprise's insolvency should not be considered an accounting event.

38. _Assessments Based on Losses_. For loss-based assessments, AcSEC concluded that the underlying cause of an insurance enterprise's obligation to pay the assessment is the incurrence of losses on which the assessments are expected to be based (regardless of whether the assessment is based on paid or incurred losses). Further, AcSEC believes that insurance enterprises have little or no discretion to avoid the future sacrifice once the losses on which the assessments are expected to be based have been incurred. Unlike premium-based assessments, where the insurance enterprise has the discretion to write or to not write premiums (even if it is unlikely that the insurance enterprise will not write such future premiums), an insurance enterprise is obligated to pay the loss-based assessments once those losses are incurred.

39. AcSEC considered whether it is appropriate to recognize a liability for assessments for administrative-type state funds as the losses on which the assessments are based are incurred by member insurers. Some have indicated that it is not appropriate to accrue a liability for operating costs of a state fund that have not yet been incurred by the state fund. AcSEC concluded that loss-based assessments for administrative-type funds should be accrued as losses of a member insurer occur if it is probable that a related assessment will be made. AcSEC believes this is similar to the accounting in FASB Statement No. 60, whereby liabilities for claim adjustment expenses that relate to unpaid claims are accrued before the costs are incurred. Once the losses are incurred, insurance enterprises have little or no discretion to avoid paying the assessment.

Present Value

40. AcSEC believes that recognizing assessment liabilities at their present value provides the most representative measure of the economic substance of the situation. Nevertheless, AcSEC declined to mandate present-value-based measurements while the FASB is still considering the role of present-value-based measurements in financial reporting. For the same reason, this SOP provides no detailed guidance on present-value methodologies and discount rates.

Premium Tax Offsets, Policy Surcharges, and Future Rate Making

41. AcSEC believes that, when it is probable that paid or accrued assessments will result in premium tax offsets or policy surcharges, recognition of an asset based on current laws and projections of future premium collections from in-force policies is appropriate. In making this determination, AcSEC considered the characteristics of an asset in paragraph 26 of FASB Concepts Statement No. 6, which states, in part:

> An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

42. Even though premium tax offsets, policy surcharges, and the incorporation of assessment costs in future premium rate structures have a similar purpose, that is, to allow insurance enterprises to recoup some portion of assessment costs, AcSEC concluded that the ability to include assessments in future premium rate structures should be treated differently from premium tax offsets and policy surcharges. Premium tax offsets and policy surcharges are statutorily provided and generally are not dependent on the ability or intent of an insurance enterprise to take

any action. In contrast, an insurance enterprise needs to write future premiums before the ability to include assessments in future premium rate structures would result in recovery of costs. Thus, AcSEC concluded that the statutory ability to include assessment costs in future premium structures should not result in asset recognition and should not be used to reduce current assessment costs.

43. To the extent that paid or accrued guaranty-fund costs are expected to result in premium tax offsets or policy surcharges, AcSEC believes that it is appropriate to consider recognition of such recoveries as assets. AcSEC believes that the amount of the asset should be limited to expected future premiums related to policies in force at the measurement date. AcSEC considered whether it is appropriate to consider all expected future premiums in establishing such recoveries. However, AcSEC concluded that this approach would introduce an inconsistency with AcSEC's decision not to recognize a liability for guaranty-fund and similar assessments that are based on future premiums. Therefore, AcSEC determined that considering all expected future premiums in evaluating the recoverability of premium tax offsets or policy surcharges is not appropriate.

Transition

44. AcSEC decided to prohibit retroactive application of this SOP. AcSEC recognizes the benefits of comparative financial statements but believes that the information needed for insurance enterprises to create the necessary estimates of liabilities for future assessments and of the timing and amounts of cash flows from a past perspective may not be available.